

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Developing a Unified Intercarrier)	CC Docket No. 01-92
Compensation Regime)	

**COMMENTS OF THE
NATIONAL EXCHANGE CARRIER ASSOCIATION, INC**

May 23, 2005

Summary

NECA has analyzed several of the intercarrier compensation reform approaches described in this proceeding in terms of effects that each might have on the rate of return companies participating in NECA's access charge pools. Approaches under analysis include the ICF plan, the NARUC Task Force Proposal Draft Version 5, concepts endorsed by members of the Rural Alliance (a combination of ARIC & EPG principles), and a pure Bill and Keep structure.

These intercarrier compensation reform approaches would generally shift costs from carriers to end users and/or universal service support funds. For example, the NARUC Draft Version 5 approach would shift cost recovery from intercarrier compensation primarily to universal service funding mechanisms, increasing funding requirements by approximately \$1.7 billion for NECA's pool members. The ICF approach would shift a total of about \$1.9 billion to end users and USF. The Rural Alliance approach would also raise end user rates and USF requirements, but because a proportionately higher amount of intercarrier compensation is retained, the total amount would be only about \$0.9 billion. A Bill & Keep approach would raise end user rates and USF requirements the most – by a total of \$2.3 billion. Under most approaches, cost recovery impacts would be most significant for the smaller carriers participating in NECA's pools.

A reasonable balance of cost recovery between intercarrier compensation, end users and universal service would help avoid these impacts. Retaining some form of intercarrier compensation would also assure continued linkage between network usage and recovery of costs driven by that usage.

If the Commission does elect to retain some form of intercarrier compensation mechanism, several implementation issues may arise. For example, while many of today's telecom carriers operating in highly competitive markets may require little regulatory intervention going forward, carriers that provide service in less competitive, high-cost areas, and who rely extensively on universal service funding to provide affordable service, may continue to need a more structured approach that retains some form of accounting, separations, and rate development rules.

Continued use of tariff arrangements may also provide the most reasonable and efficient solution to setting interconnection rates, terms and conditions for these carriers. Regardless of how intercarrier rates are set, however, effective enforcement mechanisms are needed to allow carriers to collect legitimate charges from service providers utilizing their networks. Absent effective enforcement, no intercarrier compensation mechanism will remain viable.

Finally, many carriers continue to need the ability to participate in common revenue pooling arrangements similar to those administered by NECA today. Revenue pooling provides substantial administrative savings and risk-sharing benefits, and can readily be adapted for use under tariffs, common contracts, or some combination of the two mechanisms.

NECA looks forward to working with industry groups, the Commission and state regulators to assure new intercarrier compensation structures are implemented successfully, with minimal disruption to pool members and the many rural Americans who depend on these carriers for high quality telecom services.

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I. INTRODUCTION

The National Exchange Carrier Association, Inc., (NECA) welcomes the opportunity to submit comments in this critical proceeding.¹

NECA is responsible under the Commission's Part 69 access charge rules for administering interstate access tariffs and revenue pooling arrangements on behalf of incumbent local exchange carriers (ILECs).² More than 1,200 rate of return companies currently choose to participate in NECA's Common Line (CL) or Traffic Sensitive (TS) access tariffs and related revenue pools.³

Commission rules authorize NECA to participate in proceedings that relate to access charge tariffs, the billing and collection of access charges and the distribution of

¹ Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, *Further Notice of Proposed Rulemaking*, 20 FCC Rcd 4685 (2005) (*FNPRM*).

² See generally Part 69, Subpart G of the Commissions' rules and regulations, 47 C.F.R. § 69.600 *et seq.*

³ As part of its pooling administration functions, NECA collects, reviews and extensively analyzes member companies' cost and revenue data for compliance with FCC rules and NECA procedures; develops interstate "average schedule" formulas that are used to determine pool settlements and universal service fund distributions to about 480 small telephone companies; and collects and analyzes loop cost data submitted by ILECs for purposes of determining high cost loop fund support. Other services provided to NECA members include training and communications on tariff and regulatory matters and processing of FCC regulatory fees.

access charge revenues.⁴ Issues raised in this proceeding obviously have the potential to alter dramatically the ways in which NECA member companies file access tariffs and collect related revenues.

These comments accordingly focus on the effects that various approaches to intercarrier compensation under discussion could have on its member companies and their customers. NECA's analyses, presented herein, show the extent to which changes in existing mechanisms could cause substantial shifts in cost recovery from intercarrier compensation mechanisms to end users and/or universal service mechanisms for pool members and their customers, particularly those located in the most rural areas of the country.

NECA's comments also focus on implementation issues associated with revised intercarrier compensation mechanisms. Today's telecom carriers are in many cases operating in dynamic, highly competitive markets and therefore need flexibility to establish individual rates, terms and conditions for their services pursuant to negotiated interconnection agreements. For NECA pool members operating in less competitive, high-cost areas, and who rely on universal service funding to provide affordable service, a more structured approach that retains some forms of regulatory accounting, separations, and tariffing rules, may be required.

⁴ 47 C.F.R. § 69.603(b). In a proceeding addressing the scope of NECA's authority under this section, the Commission found that NECA's "unique perspective, information, and expertise should be available to this Commission in making determinations that have broad and far-reaching affects upon exchange carriers, ratepayers, and the provision of telecommunications services. As the national administrator of pooled interstate exchange carrier revenues, NECA is uniquely positioned to provide data, analysis, and perspectives on national telecommunications policy issues that affect the exchange and interexchange carrier industries." Amendment and Clarification of Part 69 Rules Governing the National Exchange Carrier Association, CC Docket No. 87-2, *Memorandum Opinion and Order*, 2 FCC Rcd 381 (1987) at ¶ 8.

Finally, many member carriers continue to need the ability to participate in common revenue pooling arrangements similar to those administered by NECA today. Revenue pooling provides substantial administrative savings and risk-sharing benefits to pool members. Regardless of whether future intercarrier compensation mechanisms are effectuated through tariffs, common contracts, or some combination of the two, rate of return carriers should continue to have the option of participating in such mechanisms.

The issues in this proceeding are extraordinarily complex. NECA looks forward to working with the Commission to assure new intercarrier compensation structures are implemented successfully, and with minimal disruption to its pool members, and the many rural Americans who depend on these carriers for telecom services.

II. IMPACT ANALYSIS OF ALTERNATIVE APPROACHES.

A number of participants in this proceeding have expressed concern over the potential effects that reform of intercarrier compensation mechanisms could have on end users and/or existing universal service mechanisms.⁵ The Commission's *FNPRM* specifically seeks comment on universal service related issues associated with proposed changes in intercarrier compensation mechanisms, including the need to maintain reasonable and affordable end-user rates and the avoidance of rate shock.⁶

To assist the Commission in evaluating this issue, NECA has conducted preliminary analyses of several reform approaches currently under discussion, focusing

⁵ *FNPRM* at ¶ 30.

⁶ *Id.* at ¶ 32.

on how these approaches might affect the telephone companies who participate in its common line (CL) and traffic sensitive (TS) pools. The approaches studied include:

- The principals endorsed by the Rural Alliance (ARIC and EPG)⁷;
- The National Association of Regulatory Utility Commissioners' Task Force Draft Proposal (NARUC Task Force Draft Version 5)⁸;
- The Intercarrier Compensation Forum (ICF) approach;⁹ and
- The "Bill and Keep" concept described in Appendix C of the *FNPRM*.¹⁰

Pool members currently receive on average about 29% of their total net telephone company operating revenue from intercarrier compensation (primarily inter- and intra-state switched access charges), and about 31% from Universal Service Funding – a substantial amount even on average. The extent to which these companies rely on intercarrier compensation can vary, however, depending upon a number of factors. For the group of pool members who rely most heavily on intercarrier compensation (i.e., those in the top 10%), reliance on intercarrier access revenues increases to an average of 49% of total net operating revenue.¹¹

⁷ *EPG and ARIC United to Form A "Rural Alliance" for Intercarrier Compensation and Universal Service Reform*, February 14, 2005, Press Release, Washington D.C.

⁸ See Letter from Robert B. Nelson, Commissioner, Michigan PSC to Michael Powell, FCC, CC Docket No. 01-92, (Mar. 1, 2005), attaching the NARUC Task Force on Intercarrier Compensation Draft Proposal Version 5. NECA has not had an opportunity to update this analysis to reflect NARUC Task Force Draft Version 7 (See Letter from Robert B. Nelson, Commissioner, Michigan PSC to Kevin Martin, FCC, CC Docket No. 01-92 (May 18, 2005)).

⁹ See Letter from Gary M. Epstein, Latham & Watkins, to Marlene H. Dortch, FCC, CC Docket No. 01-92 (Oct. 5, 2004), attaching Intercarrier Compensation Forum's Plan, and Brief in support of the Plan.

¹⁰ Additional approaches may be proposed as this proceeding moves forward. See, e.g., Letter from Alex J. Harris, Frontier, to Marlene Dortch, Secretary, FCC (May 10, 2005) (proposing a Universal Telecommunications Freedom (UTF) plan). NECA plans to continue evaluating potential alternative approaches for intercarrier compensation reform and will provide further analyses as necessary.

¹¹ This group includes about 124 companies. For a smaller number of these carriers, reliance on intercarrier compensation revenues is likely to far exceed even these high levels. Data available to NECA for this study was not sufficient, however, to determine individual company impacts at this level of detail.

The following table is designed to illustrate the impacts on cost recovery for pool members by comparing the first three of these approaches to the *status quo* with respect to cost recovery shifts.¹²

TABLE 1
ANALYSIS OF ALTERNATIVE ICC PLANS FOR NECA POOL MEMBERS
(\$ Millions)

ALTERNATIVE	TOTAL INTER-CARRIER REVENUE	NEW END USER REVENUE	TOTAL END USER REVENUE	NEW RESIDUAL FUND	TOTAL USF + NEW FUND	TOTAL COST RECOVERY
Status Quo	\$2,303.6	\$0.0	\$3,177.8	\$0.0	\$2,511.3	\$7,992.60
% of Total	29%		40%		31%	100%
Rural Alliance*	\$1,411.7	\$274.6	\$3,452.3	\$617.4	\$3,128.6	\$7,992.60
% of Total	18%		43%		39%	100%
NARUC (Draft V.5)	\$572.4	\$0.0	\$3,177.8	\$1,731.2	\$4,242.4	\$7,992.60
% of Total	7%		40%		53%	100%
ICF	\$410.7	\$342.8	\$3,520.5	\$1,550.1	\$4,061.3	\$7,992.60
% of Total	5%		44%		51%	100%

* as the Rural Alliance has not yet proposed a specific plan, these figures represent a composite of the ARIC and EPG proposals.

The first column of Table 1 identifies the intercarrier compensation approach under analysis. The second column displays sums of estimated intercarrier revenues from intra- and interstate switched access and net reciprocal compensation under each approach.¹³ The third column represents new end-user revenue projected in several of the proposals. The fourth column combines existing end-user revenue, which includes basic local revenue, interstate subscriber line charges (SLCs) and new end user revenues.¹⁴ The next two columns show, respectively, the funds shifted to a new residual support fund and a total sum of support funding, including current state access-related universal

¹² The "Bill and Keep" approach set forth in Appendix C of the *FNPRM* has not been included in this chart because it is unclear how residual costs under that approach would be allocated between end users and universal service funding.

¹³ Excludes special access revenues.

¹⁴ Excludes private line, toll and vertical services.

service funding (USF), interstate USF,¹⁵ plus any new proposed residual funds. The column showing total cost recovery (100%) is the sum of the prior columns consisting of intercarrier compensation, end-user revenue, and support funding, and is based on current estimates in the Status Quo alternative.

It must be emphasized that the above analysis is based on sample data¹⁶ and relies on significant estimates and assumptions. For example, NECA used data underlying its 2003 annual tariff filing to derive interstate switched access revenue, interstate SLC revenue and interstate USF funding for TS pool members.¹⁷ Intrastate switched access revenue, net reciprocal compensation amounts, and state USF funding were estimated based on a sample of data from 427 rate of return study areas. For companies not included in this sample, these data were developed by analyzing information from companies of similar line sizes that were included in the sample. Basic local revenue was estimated using sample data from a data request sponsored by NTCA reflecting 305 rate of return study areas. Local rate and revenue data for companies not included in the NTCA sample were developed using statewide average information derived from companies included in the sample.¹⁸

These estimates and assumptions notwithstanding, NECA's analysis provides a reasonable assessment of the aggregate impacts on pool members of the various proposed

¹⁵ Including High Cost Loop (HCL) support, Long Term Support (LTS), Interstate Common Line Support (ICLS), and Local Switching Support (LSS).

¹⁶ Sampling was necessary because, for example, NECA does not collect intrastate revenue data in its role as administrator of interstate access tariffs and pools.

¹⁷ For companies that participate in the CL pool but who file their own TS tariffs, NECA developed interstate traffic sensitive amounts based on an analysis of data underlying access tariff filings.

¹⁸ Assumptions underlying the individual proposed approaches and further detail on the data sources are explained more fully in the Appendix to these Comments.

intercarrier compensation approaches. Table 1 shows, for example, the NARUC Draft Version 5 approach does not impose any additional overall cost recovery burden directly on pool members' end users. However, it shifts the majority of cost recovery to the USF – increasing universal service from the current 31% to 53% for pool participants.

The ICF approach increases the aggregate cost recovery burden on pool members' end users from the current 40% to 44%, amounting to an additional \$342.8 million, and also shifts a significant recovery burden to USF – raising that overall percentage from 31% to 51% for CL pool participants.

The Rural Alliance approach (a composite of the EPG and ARIC proposals) shifts aggregate cost recovery both to end users (from 40% to 43%) and the USF (from 31% to 39%), but these shifts are smaller because a higher percentage of cost recovery from intercarrier charges is retained – albeit at reduced levels from existing rate levels.

This analysis assesses impacts only on the rate of return telephone companies that participate in NECA's pools and therefore excludes all price cap carriers.¹⁹ It should also be noted that these analyses do not reflect cost impacts that may be caused by demand stimulation effects associated with pricing intercarrier traffic at zero or near-zero levels. To the extent that pool members are forced to charge low rates (or no rates) for intercarrier traffic, interconnecting carriers could be expected to redirect traffic to lower-priced substitute services (*e.g.*, from special to switched access) that may not necessarily be the most efficient, thus driving up and/or shifting network costs to other users.

Uneconomic demand stimulation could require additional investment in switched access

¹⁹ NECA pool members include many of the same carriers described as “Covered Rural Telephone Companies” (CRTC's) under the ICF proposal, but the two groups are not identical. Results of NECA's impact analyses therefore may not correspond precisely to results of impact analyses prepared with respect to CRTC's or other discrete groups of rural carriers.

network components, which would, in turn, exacerbate cost shifts to end users and/or universal service funding.²⁰

Sample data underlying this overall directional analysis are not sufficient to estimate detailed impacts at the state or study area level. It is important to observe, however, that actual impacts on pool members' customers and/or universal service would also vary greatly depending upon the number of access lines served by a carrier. The following table therefore provides a combined impact analysis of the loss of intercarrier compensation from each of the four approaches described above, based on line-size groupings (e.g., study areas with less than 500 lines, with 501- 1,000 lines, etc.). This table shows additional amounts that would need to be paid by end users and/or funded from universal service under the various approaches under study.

²⁰ For example, existing access rates incorporate various cross-over points between switched and special access services that reflect the underlying economic costs of providing service. If carriers are required to transport other carriers' traffic with cost-recovery not reflective of actual costs, switched networks could be faced with significant additional traffic loads. The availability of zero or near-zero switched service rates could also incent large corporate users and ISPs to claim carrier status so as to avoid paying retail rates for services. These users would also be likely to seek to interconnect at tandem switches in order to gain "free" access to the network of both large and smaller carriers. A rational intercarrier compensation mechanism, in contrast, links prices to usage and customer behavior. When economic consequences are linked to a behavior, both carriers and customers are given incentives to use network resources efficiently, and pool members retain incentives to invest in maintaining and upgrading their networks.

TABLE 2
IMPACTS OF LOSS OF INTERCARRIER COMPENSATION REVENUES UNDER
ALTERNATIVE ICC APPROACHES BY LINE SIZE GROUP

Alternative	<500	501-1000	1001-2500	2501-5000	5001-10,000	10,001-20,000	20,001-50,000	>50,000	TOTAL/AVERAGE
Line %	0.2%	0.9%	4.4%	6.4%	11.5%	14.3%	15.3%	47.0%	100.0%
No. of Study Areas	101	152	328	216	203	128	64	49	1241
RURAL ALLIANCE									
Total Residual	\$1.1	\$7.0	\$42.3	\$81.6	\$135.0	\$146.8	\$133.5	\$344.6	\$891.9
Monthly Per Line Residual	\$3.03	\$5.11	\$6.47	\$8.60	\$7.85	\$6.89	\$5.83	\$4.90	\$5.97
NARUC (Draft V.5)									
Total Residual	\$12.1	\$34.8	\$138.9	\$151.3	\$249.8	\$255.5	\$211.5	\$677.3	\$1,731.2
Monthly Per Line Residual	\$34.46	\$25.31	\$21.23	\$15.94	\$14.53	\$12.00	\$9.24	\$9.64	\$11.59
ICF									
Total Residual	\$13.9	\$37.7	\$152.6	\$170.4	\$279.7	\$286.2	\$235.3	\$717.2	\$1,892.9
Monthly Per Line Residual	\$39.59	\$27.42	\$23.31	\$17.96	\$16.26	\$13.44	\$10.28	\$10.21	\$12.67
BILL & KEEP									
Total Residual	\$15.6	\$42.2	\$174.1	\$201.3	\$334.6	\$350.1	\$299.0	\$886.7	\$2,303.6
Monthly Per Line Residual	\$44.51	\$30.66	\$26.60	\$21.21	\$19.45	\$16.44	\$13.07	\$12.62	\$15.42

“Total Residual” amounts in Table 2 are expressed in millions of dollars per year, while “Monthly Per-Line Residual” amounts are expressed in dollars per line per month. Monthly per-line residual impacts are larger for smaller-sized service areas under the NARUC, ICF and Bill and Keep approaches. Under the ICF approach, for example, pool members with more than 50,000 lines would need to recover an additional amount of \$10.21 per line per month from universal service and/or end users to remain whole, while companies with less than 500 lines would need an additional \$39.59 per line per month. Similarly, under the NARUC approach, larger pool members would face a per-line shortfall on average of \$9.64 per month, with shortfalls increasing to \$34.46 per line per month on average for the smallest companies.

For illustrative purposes, NECA also included in this chart an analysis of the residual effects of moving to a pure Bill and Keep approach on companies of various line

sizes (*i.e.*, one that sets the intercarrier compensation rate at zero as suggested by the staff report in Appendix C of the *FNPRM*). This analysis shows a pure Bill & Keep approach would require pool members to recover, on average, an additional \$15.42 per line per month of lost intercarrier compensation either from the Universal Service Fund or from higher customer charges. As noted above, however, this average masks the disproportionate risk faced by end users in smaller service areas. For the group of study areas with fewer than 5,000 access lines, average revenue shortfalls under a pure Bill and Keep approach would range from \$21.21 to \$44.51 per line per month.

The Rural Alliance approach, in contrast, leaves smaller residual amounts to be recovered from end users and/or universal service. Under this approach, residual per-line amounts increase from \$3.03 per line per month for the smallest companies to a peak of \$8.60 per line per month for the 2501-5000 line category. Residual amounts then drop to \$4.90 per line per month for the largest line size category.²¹

By way of illustrating the potential impact on customers of pool members, NECA calculated that if all residual amounts were to be recovered from end-users, average monthly rates for basic residential local service under the Rural Alliance approach would increase from the estimated current rural average local rate of \$12.19 per month²² to \$18.16, a 49% increase (before the application of state or federal SLCs, USF contribution pass-throughs, and other regulatory fees and taxes). The increase would be approximately 104% under the ICF approach, to \$24.86. Under a pure Bill & Keep

²¹ This unusual pattern is caused by a few study areas in the smallest line-size categories whose estimated intrastate revenues are lower than their interstate revenues. See Appendix at 1.

²² This average basic local service rate was derived from a sample of 305 study areas that supplied basic local rates for calendar year 2002 to NTCA. Rates for non-respondents were estimated by either state or regional averages for respondents. See the appendix heading "Data Sources, NTCA Data Request" for further details. The average bill increases are the per line residuals shown in the last column of Table 2.

approach, monthly residential basic local service rates could increase by 127% on average.²³ Again, these average impact percentages mask impacts on individual service areas. For example, end-user rates for service areas with less than 1,000 lines could rise by more than 200% under several of the approaches.

On the other hand, if all residual amounts were to be recovered entirely from the Universal Service Fund,²⁴ under the Bill & Keep approach the Fund size in 2003 would have had to increase by 43 percent, from \$5.4 billion to \$7.7 billion.²⁵ Under the ICF approach, the Fund size would have had to increase by \$1.9 billion or 35% (from \$5.4 b to \$7.3 b), and under the NARUC Draft 5 approach it would have had to increase by \$1.7 billion or 31% (from \$5.4 b to \$7.1b). The Rural Alliance approach would have increased the Fund size by \$0.9 billion or 17%.

III. IF THE COMMISSION ELECTS TO RETAIN SOME FORM OF INTERCARRIER COMPENSATION, IT SHOULD PERMIT RATE OF RETURN CARRIERS TO USE THE MOST EFFECTIVE MEANS AVAILABLE TO SET RATES, TERMS AND CONDITIONS.

The information presented above indicates a need for the Commission to maintain a reasonable balance in cost recovery among end users, universal service, and intercarrier compensation. Continued recovery of a reasonable portion of network costs from interconnecting carriers helps avoid creating uneconomic incentives that may drive up end user rates and/or demand on universal service funds.

²³ As explained above, the NARUC plan tends to shift cost recovery to universal service funding mechanisms. While increases in universal service funding requirements can also be expected to be reflected in higher end user USF line-item charges, those impacts would not be expected to fall disproportionately on customers of smaller companies.

²⁴ These increases represent changes associated only with loss of intercarrier revenues by NECA pool rate of return carriers and are based on the assumption that all replacement revenue would come from additional universal service funding.

²⁵ *Universal Service Monitoring Report*, CC Docket No 98-202, Table 1.11, Section 1 (October 2004) at 36.

Assuming, then, that the Commission elects to retain some form of intercarrier compensation structure going forward, NECA offers the following observations to help assure that revised mechanisms are effective in meeting the Commission's goals in this proceeding.

A. Methods of Determining Intercarrier Compensation Rates.

NECA pool members serve about 8% of total access lines in the United States and its territories. Their service areas, however, are vast -- encompassing about 38% of the nation's land area.²⁶ As a result, these companies generally do not enjoy the economies of scale available to their large, non-rural counterparts. Following are comparisons of subscriber densities and transport distances that help explain higher costs for rural carriers.

The average rural company serves areas with only about 10.5 lines per square mile.²⁷ In extremely rural states service territories are far more sparse. In Alaska and Wyoming, for example, rural carriers serve areas with average population densities of only 0.58 and 1.25 persons per square mile, respectively.²⁸ Larger non-rural carriers, in contrast, average 134 lines per square mile, and often serve thousands of customers per square mile.²⁹

²⁶ *The Rural Difference*, Rural Task Force, White Paper 2 (January 2000) (*RTF White Paper 2*).

²⁷ *Trends in Telecommunications Cost Recovery: The Impact on Rural America*, National Exchange Carrier Association, Inc. (October 2002) (*NECA Cost Recovery Report*) at 4.

²⁸ *RTF White Paper 2* at 9.

²⁹ The average number of lines per switch for rural carriers is only 2,201, as opposed to 13,314 lines per switch for non-rural carriers. Moreover, rural carriers serving fewer than 500 lines average 257 lines per switch. See *NECA Cost Recovery Report* at 5.

These companies are often required to deploy long microwave or fiber links to connect their switches to each other and to the switches of neighboring larger companies. Twenty-two percent of the wire centers in the pool are over 100 miles from a major LATA tandem. An additional 31% are between 50 to 100 miles from their LATA tandem.³⁰

Rural connections to the Internet backbone also span long distances. Most of the service territories of rural telecom companies are far from an Internet node site. In a 2001 study, NECA demonstrated 55% of the rural telephone switches listed in Tariff 4 are 70 miles or more from one of the Internet nodes of the 34 largest Internet Backbone Providers (IBPs).³¹ Thirty-five percent are more than 100 miles away, and 10% are more than 200 miles away. In specific states the distances become even more significant. In Alaska, 82% of rural telecom company switches are more than 200 miles away from an IBP node, and many are more than 700 miles away. In Idaho and South Dakota, 49% and 57% of rural telephone company switches, respectively, are more than 200 miles from an Internet node.³²

Existing cost-based intercarrier compensation mechanisms make it possible for local telephone companies to build and maintain the infrastructure that makes the provision of basic exchange and exchange access telecom services, as well as new advanced services such as Internet access, VoIP, etc., possible in rural areas. The unique circumstances faced by rural carriers indicate that intercarrier rates for pool members

³⁰ Measured along a straight line from the boundary of a wire center serving area to the LATA tandem.

³¹ NECA's *Middle Mile Broadband Cost Study*, National Exchange Carrier Association, Inc. (November 2001) (*NECA Middle Mile Study*) at 16.

³² *Id.* at 17.

should continue to be based on accounting and costing procedures that are definable, verifiable and that reflect the actual circumstances faced by these carriers in providing service in rural areas.

Booked costs appear best to meet these three criteria. Carrier costs booked according to Commission accounting rules can be clearly defined and subject to accurate validation via internal and external company audits, NECA data reviews, and audits and reviews conducted by the Commission and state regulatory bodies. Booked costs also reflect actual investment and expense levels incurred by pool members in providing service. The use of booked costs has been vital for small carriers in order for them to recover their costs and continue to provide basic services and introduce new services in rural areas.³³ Further, such costing methods result in prices that send the correct economic signals to carriers and end users and, if applied equally to all traffic,³⁴ avoid the arbitrage problems similar to those that are undermining existing intercarrier compensation mechanisms.

B. Uniform Application of Rates and Effective Enforcement Mechanisms.

In the *Inter-carrier Compensation NPRM*, the Commission observed that regulatory arbitrage arises from different rates that different types of providers must pay

³³ TELRIC costing methods, in contrast, seek to estimate the forward-looking cost associated with segments of the physical network, such as the cost of a switch or transport pipe. These cost estimates are virtually impossible to verify. Existing TELRIC proxy models are also built on simplifying assumptions that may not reflect actual circumstances faced by pool members. The Rural Task Force, recognizing the shortfalls of TELRIC, conducted extensive studies regarding the application of proxy models to rural ILECs and recommended proxy models not be used to calculate universal service support for these companies. See, e.g., A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies, Rural Task Force, White Paper 4 (September 2000) (*RTF White Paper 4*). Nothing has changed since then to make these models more accurate or to enable them to determine costs of carrier-to-carrier interconnection.

³⁴ Because costs are incurred for both originating and terminating intercarrier traffic appropriate charges for both may be necessary, especially where equal access obligations apply.

for essentially the same functions.³⁵ Based on the record compiled in the initial phase of this proceeding the Commission has determined that new intercarrier compensation mechanisms should limit arbitrage concerns that arise from regulatory distinctions unrelated to cost differences.³⁶

The *FNPRM* likewise expresses concern that rate disparities in today's system can cause some service providers to find ways to "game the system" in order to reduce their costs in the highly competitive telecommunications market.³⁷ For example, an IXC providing both interstate and intrastate toll service may claim its traffic is primarily interstate because interstate access rates are usually lower than intrastate rates. If a carrier has both CLEC and IXC operations, it has an incentive to report its traffic as local because reciprocal compensation rates are typically lower than access. Carriers interconnecting via third-party carriers (*e.g.*, at an RBOC tandem) have incentives to send traffic over those links, whether the traffic is destined to the RBOC exchanges or to any of the exchanges of subtending rural ILECs. By this method, a carrier is often able to avoid all charges, whether interstate, intrastate or local, and pay no compensation whatsoever to subtending pool members for the use of their networks.

These arbitrage problems must be resolved in order for revised intercarrier compensation mechanisms to be workable going forward. Charges for like services or facilities should be the same regardless of regulatory classification, jurisdiction, or technology used to provide a service. A uniform rate for similar services does not

³⁵ Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, *Notice of Proposed Rulemaking*, 16 FCC Rcd 9610 (2001) at ¶ 12 (*Intercarrier Compensation NPRM*).

³⁶ *FNPRM* at ¶ 33.

³⁷ *Id.* at ¶¶ 15, 33.

necessarily mean all carriers across the country charge the same rate, as this would clearly not reflect the widely divergent cost characteristics of all ILECs. It does mean, however, an ILEC or group of ILECs with common cost characteristics should be able to charge similarly-situated customers the same rate for “like” services.³⁸

“Phantom traffic” problems must be eliminated as well if any intercarrier compensation system is to survive long term. A sizable portion of traffic now terminating on ILEC switches is being delivered in a form in which the billing information is absent, lost, stripped or altered. Studies have indicated upwards of 20% of traffic in some studied offices is lost.³⁹ As noted above, pool members rely heavily on intercarrier revenue streams to provide affordable local service to rural communities. Interconnecting carriers should not be permitted to gain free access to and utilize other carriers’ networks by fraudulent means such as stripping call detail or otherwise misidentifying traffic. Even when the originating service provider of the “phantom traffic” is discovered, there are no penalties imposed and the result appears to be the offending service provider learns how to improve their “phantom” techniques. The use of these network resources should be paid by service providers sending traffic; otherwise, cost recovery is unfairly and inefficiently shifted onto other parties.

The Commission should implement reasonable and prompt enforcement mechanisms to allow collection of legitimate charges from service providers using other

³⁸ Rate banding techniques used in NECA’s access tariff provide an example of a pricing approach that permits groups of ILECs with similar cost characteristics to charge rates reflecting those costs. *See, e.g., Description and Justification*, Tariff FCC No. 5, Transmittal No. 1030, Volume 5, Section 3 (June 16, 2004).

³⁹ *See, e.g.,* Josh Long, *Rural Telcos Grapple to Identify Phantom Traffic*, Xchange Magazine (April 1, 2004) <<http://www.xchangemag.com/articles/441coverstory3.html>>.

carriers' networks to provide services. In addition to clear and enforceable "truth in labeling" requirements, penalties and arbitration procedures should also be required. If some carriers are permitted to avoid paying their share of network costs via such avoidance techniques, the system will be abused and will ultimately fail regardless of whether economically efficient unified intercarrier compensation mechanisms are in place.

C. Use of Tariffs to Implement Revised Intercarrier Compensation Mechanisms.

The *FNPRM* asks a number of questions relating to implementation of a unified intercarrier compensation mechanism, including whether it would be feasible for carriers to rely solely on agreements instead of tariffs to govern intercarrier compensation rates, terms and conditions, and what default compensation rules should apply if parties exchange traffic in the absence of a negotiated agreement.⁴⁰ In this regard, the *FNPRM* recognizes that, while price cap LECs have ample experience with the negotiation and arbitration of such agreements, the same is not true for rate of return carriers.⁴¹ The Commission also asks parties to identify unique obstacles faced by rate of return carriers in connection with a regime based solely on negotiated agreements, and further asks whether it would be possible to develop something comparable to the pooling process that takes place for carriers participating in the NECA tariff.⁴²

It may be premature to determine specific implementation strategies for revised intercarrier compensation mechanisms. It is unclear, for example, how the jurisdictional

⁴⁰ *FNPRM* at ¶ 116.

⁴¹ *Id.*

⁴² *Id.*

and economic issues identified in the *FNPRM* will be resolved. It is possible Congress will revise provisions of the Act relating to the scope of Commission jurisdiction over telecommunications services under Titles I and II of the 1934 Act, or provisions that establish existing boundaries between federal and state jurisdiction. Such changes, if they occur, may well extend to statutory provisions and rules governing the processes by which tariffs are filed and local interconnection arrangements negotiated.

In light of this uncertainty, the Commission should seek to maintain a flexible approach to implementation details that can, to the extent possible, accommodate both tariff arrangements and negotiated agreements. For carriers operating in competitive markets, who receive universal service funding, if at all, on the basis of model results rather than embedded costs and who are negotiating with carriers of comparable size and market power, there may be little need for regulatory intervention in the negotiation process. The Commission in these instances could largely seek to forbear from imposing tariff filing requirements or specific rules governing interconnection rates, terms and conditions. In cases where these conditions don't exist, continued regulatory oversight may well be required.

It is worth noting that, because of the relationship between existing universal service support mechanisms and intercarrier compensation mechanisms, some form of cost accounting, separations and pricing regulations may well be needed for pool members in any event. Existing current high cost universal service mechanisms rely on analysis of booked total company costs for purposes of determining high cost loop and local switching support payments. In the case of Interstate Common Line Support, payments are determined on a residual basis by subtracting end user common line

revenues from interstate common line revenue requirements. Similarly, local switching rates are derived on a residual basis by subtracting local switching support amounts from local switching revenue requirements. Both systems, in other words, rely on booked costs to determine funding amounts. To the extent that universal service support payments continue to be determined on this basis, it would appear that some form of intercarrier pricing rules should be maintained as well – otherwise, carriers could potentially have incentives to set intercarrier rates at uneconomically low levels and allow the remaining amounts to be recovered via universal service payments.

Since rates based on booked costs can apply regardless whether tariffs or negotiated agreements are used, the choice focuses on the relative administrative effectiveness and efficiencies of each mechanism. For pool members, at least, cost-based tariffs may provide the most effective and economical alternative for implementing intercarrier compensation.⁴³

As the Commission considers the massive administrative difficulties for pool members associated with establishing contractual relationships to govern interconnection rates, terms and conditions under a unified intercarrier compensation mechanism, it may well conclude tariff arrangements provide the most reasonable and efficient solution for these carriers. Tariffs provide for substantial flexibility in setting rates that reflect costs and can accommodate the needs of similarly situated groups of customers.⁴⁴

⁴³ As is the case under the Commission's current Part 69 access charge rules, participation in NECA intercarrier compensation tariffs and associated revenue pools should continue to be voluntary.

⁴⁴ In addition to rate banding techniques, NECA's existing tariffs include several discount pricing arrangements that align rates with costs.

Tariffs are also useful in instances where intercarrier agreements cannot be reached because it would be infeasible for pool members to negotiate with numerous and varied service providers who individually terminate comparatively small amounts of their traffic in a particular carrier's territory, but who collectively impose terminating traffic loads that are significant to a small company's network. This would include current cases where pool members are required to terminate traffic that transits another ILEC's network, but originates from a carrier with whom the terminating RLEC does not have a direct relationship.

The Commission has sought to address this situation in a recent declaratory ruling addressing the lawfulness of wireless termination tariffs.⁴⁵ The Commission's *T-Mobile Order* prospectively prohibited state tariffs which imposed default rates, terms and conditions on wireless carriers sending traffic into RLEC exchanges where an intercarrier compensation agreement did not exist.⁴⁶ In its declaratory ruling, however, the Commission added a new rule requiring a wireless carrier terminating traffic in ILEC exchanges to enter into interconnection negotiations upon request by the ILEC.⁴⁷

Several wireless carriers have sought reconsideration of this Commission decision to impose negotiation obligations on wireless carriers, advancing both procedural and

⁴⁵ Developing a Unified Intercarrier Compensation Regime, T-Mobile *et al.* Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination Tariffs, CC Docket No. 01-92, *Declaratory Ruling and Report and Order*, 20 FCC Rcd 4855 (2005) (*T-Mobile Order*).

⁴⁶ *Id.* at ¶¶ 13-15.

⁴⁷ *Id.* at ¶ 16. This requirement was seen as necessary to give subtending ILECs the ability to compel negotiations with wireless carriers in order to secure terminating compensation. It remains unclear whether this approach or any other non-tariff means of extending compensation obligations will be effective in avoiding imposition of *de facto* bill and keep arrangements on subtending ILECs.

substantive arguments.⁴⁸ It is likely that the Commission's decision will be challenged in court as well. Regardless of the ultimate disposition of the specific controversies raised in the *T-Mobile* proceeding, the Commission should not allow a decision developed in the narrow context of state wireless termination tariffs to determine the much broader policy questions raised in this proceeding.

If the Commission nevertheless promulgates rules in this proceeding invalidating existing tariff arrangements going forward, carriers will need substantial time, and specific direction, as to how revised intercarrier compensation mechanisms are to be implemented.⁴⁹ As shown above,⁵⁰ pool members rely heavily on existing intercarrier compensation revenues. These revenues are currently derived almost exclusively from access tariffs filed with the FCC and state commissions. Invalidation of these tariffs, without a substantial transition period and clear understanding as to how replacement mechanisms will work, would invite regulatory and financial chaos and severely harm pool members and their customers.

D. Use of Common Intercarrier Compensation Revenue Pools.

The Commission asks whether it is possible to develop something comparable to the pooling process that takes place for carriers that participate in the NECA tariff.⁵¹ Existing pooling mechanisms promote financial stability and administrative efficiencies for pool members and should be permitted to continue. These carriers are generally quite

⁴⁸ See, e.g., Petitions for Reconsideration and/or Clarification filed on or before April 29, 2005 by American Association of Paging Carriers, Rural Cellular Association, MetroPCS, and T-Mobile.

⁴⁹ *FNPRM* at ¶ 117 (seeking comments on what type of transition would be needed for a new regime).

⁵⁰ *Supra*, section II.

⁵¹ *FNPRM* at ¶ 116.

small and need stable cash flow to assure the continuation of universal and high-quality services in rural high-cost areas. Pooling provides these carriers with administrative efficiencies and risk management benefits they would not be able to achieve alone (e.g. stabilizing cash flows, enabling access to capital via assurances of adequate cost recovery and a fair rate of return, etc.). Further, pooling reduces administrative burdens on regulators and individual carriers under either tariff or contract.

Therefore, regardless of whether intercarrier compensation rates, terms and conditions are set by tariff, contract, or some combination of the two, rate of return carriers should have the option of participating in revenue pooling arrangements. NECA believes it can make pooling work under a number of different plan scenarios, and has in place systems and resources that can readily be adapted to changes in the Commission's rules governing intercarrier compensation mechanisms. A key requirement in this regard is a consistent set of accounting and separations rules that would continue to apply to revenue and cost determinations, with appropriate regulatory oversight.⁵² While it is perhaps too early in this proceeding to determine with specificity how such arrangements would function, NECA looks forward to working out necessary details with its pool members and with federal and state regulators as more fundamental issues with intercarrier compensation are resolved.

IV. CONCLUSION

The issues raised in this proceeding are extraordinarily complex and will require rigorous analyses to determine the potential effects of any proposed changes on all the players in today's telecom industry. NECA is uniquely positioned to play a key role in

⁵² It appears such accounting rules and oversight will be necessary in any event, at least for those pool members recovering interconnection costs via some combination of intercarrier compensation charges and universal service funding. *Supra*, at 18.

such analyses for its pool members. With industry cooperation, NECA could also provide its expertise to perform analyses for a wider set of industry players as well. In any event, rigorous analyses of the various approaches are critical to determining which reforms will allow the Commission to meet its dual objectives of supporting both competition and universal service.

NECA believes that it is important for the Commission to retain some form of intercarrier compensation because it sends appropriate economic signals to the market by linking network usage and recovery of costs driven by that usage. For rural ILECs interconnection rates based on actual booked costs provide a means for the Commission to ensure that costs are verifiable and that these small carriers can continue to provide universal service in their territories

The Commission should seek to maintain a flexible approach to implementation details that can, to the extent possible, accommodate both tariff arrangements and negotiated agreements. For rate of return rural carriers operating in less competitive markets, and who are dependent on universal service funding, a more structured approach to cost recovery continues to make sense. Continued use of tariff arrangements may provide the most reasonable and efficient solution in these cases. Regardless of the intercarrier compensation mechanism chosen, the Commission should implement enforcement mechanisms to allow collection of legitimate charges from service providers utilizing other carriers' networks. In addition to clear and enforceable "truth in labeling" requirements, penalties and arbitration procedures are also needed.

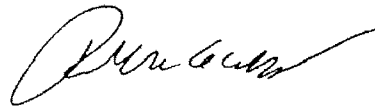
Finally, ILECs should be able to participate in common revenue pooling arrangements. NECA stands ready to work with industry groups, the FCC, and state

regulators to develop implementation strategies for revised intercarrier compensation rules that accomplish the Commission's goals in this proceeding while assuring rural customers continue to receive high quality, reliable and affordable telecommunications services.

Respectfully Submitted,

NATIONAL EXCHANGE CARRIER
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APPENDIX

Summary of Assumptions and Data Sources

The summary tables in Section II of NECA's Comments display projected changes in funds flows to Common Line Pool participants if any one of four approaches to intercarrier compensation reform is adopted:

1. Rural Alliance
2. NARUC Draft Version 5
3. ICF
4. Bill and Keep

Because the Rural Alliance has not as yet proposed a specific plan, the one displayed here is a composite of the ARIC and EPG proposals.

Summary of Assumptions

The following is a summary of the data assumptions for each of the four ICC approaches price outs:

ICC Approach	Data Assumption																				
Rural Alliance	<ul style="list-style-type: none">Reduce intrastate switched access rates to an approximate \$.02 rate using as a surrogate interstate access cost levels, which produce an approximation to an average rate of \$0.0215 per minute. (Note: rate banding was not applied to the line size table.)<ul style="list-style-type: none">For study areas with intrastate rates already at or below interstate cost levels, no adjustment to intrastate access revenue.No change to reciprocal compensation revenue, assume comparable to interstate cost level.Estimate net increase in local revenue by moving flat-rate residential local rates to the nationwide local benchmark rate of \$14.61 per month.Estimate the size of the New Residual Fund needed to recover revenues lost from decreasing intrastate rates, offset by increasing local revenues as a result of re-balancing local rates to national benchmark.SLC rates remain unchanged.Note: Rate structures based on current per minute or capacity based rates have no affect on price outs because either one is assumed to be revenue neutral.Assumes interstate access cost levels equal to the 2003-2004 tariff test period.																				
NARUC Draft Version 5	<ul style="list-style-type: none">Reduce originating access to zero.Reduce terminating access rates to: <div>NECA Common Line Pool<table><tr><th>Access Lines in Wire Center</th><th>Termination Rate per Minute</th><th>Wire Centers</th><th>Percent of Access Lines</th><th>Percent of MOU</th></tr><tr><td>Greater than 5,000</td><td>\$0.002</td><td>404</td><td>41.0</td><td>39.4</td></tr><tr><td>500-5,000</td><td>\$0.005</td><td>3,622</td><td>53.6</td><td>54.2</td></tr><tr><td>Less than 500</td><td>\$0.01</td><td>2,238</td><td>5.4</td><td>6.3</td></tr></table></div>	Access Lines in Wire Center	Termination Rate per Minute	Wire Centers	Percent of Access Lines	Percent of MOU	Greater than 5,000	\$0.002	404	41.0	39.4	500-5,000	\$0.005	3,622	53.6	54.2	Less than 500	\$0.01	2,238	5.4	6.3
Access Lines in Wire Center	Termination Rate per Minute	Wire Centers	Percent of Access Lines	Percent of MOU																	
Greater than 5,000	\$0.002	404	41.0	39.4																	
500-5,000	\$0.005	3,622	53.6	54.2																	
Less than 500	\$0.01	2,238	5.4	6.3																	

	<ul style="list-style-type: none"> • Set transport terminating rate at \$0.0095 if wire center to study area edge distance is 200 miles or less, otherwise set terminating transport rate at \$0.019. • Estimate the new Residual Fund, <i>Rural Access Charge Transition Fund</i>, to offset reductions in access charges. • A capacity-based rate structure was not used to re-estimate access revenues. This does not affect the price outs because capacity-based rate setting is assumed to be revenue neutral. • Assume federal universal service funds equal the 2003-2004 test period funds.
ICF	<ul style="list-style-type: none"> • Reduce originating access to zero. • Reduce terminating access and reciprocal compensation to \$0.0095. • Increase Residential/Single Line Business (SLB) SLC to \$9.00 and Multiple Line Business (MLB) to \$10.00. • Estimate new Residual Fund, "<i>Transitional Network Recovery Mechanism</i>" ("TNRM") to provide support for lost intercarrier compensation revenues, offset by SLC increase.
Bill and Keep	<ul style="list-style-type: none"> • Reduce originating and terminating access and reciprocal compensation to zero.

Data Sources

The following table provides the data sources, data items and comments on growth and allocation methodologies used to develop the price outs in the summary tables in Section II. To maintain consistency with the 2003 Association Data Request sample, NECA sourced data from the same or close to the same time period, when data was available. Since the 2003-2004 test period, interstate TS switched access rates have trended downward from about \$0.0215 to about \$0.019 per minute with rate banding applied.

Data Source	Data Items	Methodology
2003 NECA Annual Access filing	<ul style="list-style-type: none"> • Interstate Switched Access • Interstate SLC • Interstate USF 	<ol style="list-style-type: none"> 1. Forecast data underlying the 2003 NECA Annual Access filing for the 2003-2004 test period. 2. Average TS switched interstate access rate equals \$0.0215.
2003 Association Data Request	<ul style="list-style-type: none"> • State Switched Access • Net Other Carrier • State USF 	<ol style="list-style-type: none"> 1. Data set included 2001 and 2002 data from 427 rate-of-return study areas. 2. Placed into ten line-size categories (see Line Size table for description) 3. Sample extrapolated to NECA CL pool level by line size segmentation. 4. A Non-respondent assigned average values for respondents in its line-size category

		<ol style="list-style-type: none"> 5. Data grown to test period 2003-2004 using 2001 to 2002 growth rates. 6. Assumed State USF estimates for 2003-2004 equaled 2002 reported amounts.
2000 U.S. Census data, revised first quarter 2001; wire center boundary data, Claritas, Inc.; MapInfo Program	<ul style="list-style-type: none"> • Switched Transport distances used in NARUC Draft Version 5 	<ol style="list-style-type: none"> 1. Allocation of MOU and lines to each wire center is based on ratios of wire center population to study area population. 2. The distance from wire center to study area edge is based on a straight line between the wire center and the LATA tandem located in the largest RBOC/ independent wire center. 3. Distance for study areas where wire center data are unavailable is set at the state average distance of study areas within the state.
2003 NTCA Data Request	<ul style="list-style-type: none"> • Basic Local Revenue 	<ol style="list-style-type: none"> 1. A sample of 305 study areas supplied basic local rates for calendar year 2002 Data Request. 2. Rates for non-respondents are set at the state average local rate for respondents when three or more study areas provided local rate data within the state. If there were two or fewer respondents in the state, the local rate for the corresponding NECA Region is used. 3. The average, basic, residential local service rate equals \$12.19. 4. The local rate was set at the targeted basic local rate of \$14.61.

Fields

The following is an explanation of the fields (column headings) in the summary tables in Section II:

Fields	Methodology
Intrastate Switched Access	Sum of intraLATA access and interLATA access including Local Switching, Transport and Carrier Common Line, if applicable.
Interstate Switched Access	Sum of interstate Traffic Sensitive switched revenue requirement less support (Long Term Support (LTS), Interstate Common Line Support (ICLS), and Local Switching Support (LSS)).
Total Carrier Access	Sum of State Switched Access and Interstate Switched Access.
Net Other Carrier	Sum of net reciprocal compensation plus net wireless and paging compensation plus net settlements with other Incumbent Local Exchange Carriers (ILECs) not included in the above.
Total Carrier Revenue	Sum of Total Carrier Access and Net Other Carrier revenue.
Basic Local Revenue	Product of basic local rate and access lines.
Interstate SLC	Defined as the total Interstate SLC revenue.
New SLC or Basic Local Rev	Revenue increases from increasing SLCs (ICF price out) or rebalancing local rates to \$14.61 (Rural Alliance price out).
Total End User Revenue	Sum of Basic Local Revenue, Interstate SLC and New SLC or Basic Local Revenue.
State USF	Sum of all state access-related Universal Service Funds.
Interstate USF (HCL, LTS, ICLS, & LSS)	Sum of HCL, LTS, ICLS, and LSS.
New Residual Fund	Recovers revenues lost from decreasing intercarrier compensation rates and, where applicable, offset by increased revenue from rebalancing local rates (Rural Alliance price out) or increasing SLCs (ICF price out).
Total USF + New Fund	Sum of State USF, Interstate USF and New Residual Fund.
Total Cost Recovery	Sum of Total Carrier Revenue, Total End User Revenue and Total USF + New Fund.

CERTIFICATE OF SERVICE

I hereby certify that a copy NECA's Comments was served this 23rd day of May 2005, by electronic delivery or electronic mail to the persons listed below.

By: /s/ Elizabeth R. Newson
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